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COMMISSIONER KENNEDY'S PROPOSED AMENDMENT NO. 1

RECEIVED

TIME/DATE PREPARED: December 15, 2010 – 1:30 p.m.

2010 DEC 15 P 1:37

COMPANY: Rio Rico Utilities, Inc. AGENDA ITEM NO. U-12

AZ CORP COMMISSION DOCKET CONTROL

DOCKET NO(S). WS-02676A-09-0257 OPEN MEETING DATE: December 14-15, 2010

Page 33, line 18 to Page 34, line 4 modified as follows:

~~We adopt Staff's recommended cost of equity and cost of capital in this case. Staff's witness utilized the DCF and CAPM to determine the cost of equity and the Hamada method to adjust for the lower risk associated with a 100 percent capital structure. The Commission has long utilized the approach Staff used in this case (constant growth DCF, two-state DCF and two-part CAPM) to determine the cost of equity. Staff's recommended cost of equity of 9.2 percent is reasonable and comparable to recent approved returns and provides the Company with the opportunity to earn sufficient returns to comply with the *Bluefield* and *Hope* standards.~~

~~The Company's proposed cost of equity is unreasonably high in light of current economic conditions. RUCO's methodology utilizing a hypothetical capital structure requires assumptions about an appropriate amount of debt and cost of debt which are subjective. RUCO cites the Commission's decision in the Gold Canyon Sewer rate case to utilize a hypothetical capital structure, but other than the common ownership of the two companies, RUCO does not offer any reason for us to depart from our usual practice of utilizing the actual capital structure and adjusting for risk using the Hamada equation.~~ At open meeting held December 14 and 15, 2010, the Company committed to file a financing application with the Commission in 2011 to infuse 20 percent debt into the Company's capital structure with an actual cost of debt of 5.7 percent. Based on that commitment, the Company has offered to use a hypothetical capital structure in this case of 20 percent debt and 80 percent equity, with a cost of debt of 5.7 percent. The parties also have agreed to use of a 9.5 percent return on equity in this case. We agree with a proposed hypothetical capital structure of 20 percent debt and 80 percent equity with a 9.5 percent return on equity and a 5.7 percent cost of debt. Applying the 9.5 percent cost of equity and 5.7 percent cost of debt to the hypothetical capital structure results in an overall weighted cost of capital for the Company of 8.74.

Make all conforming changes.

Arizona Corporation Commission
DOCKETED
DEC 15 2010
DOCKETED BY

THIS AMENDMENT:

______ Passed ____________ Passed as amended by ________________________

______ Failed ______ Not Offered ______ Withdrawn